

projections is to look at the growth of nonfarm business GDP, which excludes the output of farms, government workers, and housing services. That measure of output, which is projected to grow slightly faster than total GDP, can be broken down into two categories: the growth in total hours worked and the growth in labor productivity. The Administration's projection of nonfarm business GDP is slightly greater than CBO's because the Administration has a

slightly more optimistic view of both the future growth in hours worked (1.4 percent a year compared with CBO's 1.3 percent) and the growth in labor productivity (also 1.4 percent versus 1.3 percent).

Given the large changes in the growth of hours worked and labor productivity since the late 1950s, the differences between the Administration's and CBO's projections are small. Hours worked rose at

**Table 4.**  
**Continued**

	Actual 1994	Forecast		Projected			
		1995	1996	1997	1998	1999	2000
<b>Three-Month Treasury Bill Rate (Percent)<sup>c</sup></b>							
CBO	4.2	6.2	5.7	5.3	5.1	5.1	5.1
Administration	4.2	5.9	5.5	5.5	5.5	5.5	5.5
<i>Blue Chip</i>	4.2	6.1	6.1	5.5	5.3	5.2	5.4
<b>Ten-Year Treasury Note Rate (Percent)</b>							
CBO	7.1	7.7	7.0	6.7	6.7	6.7	6.7
Administration	7.1	7.9	7.2	7.0	7.0	7.0	7.0
<i>Blue Chip</i> <sup>d</sup>	7.1	7.6	7.4	7.2	7.1	7.0	7.2
<b>Nominal Income (Percentage of GDP)</b>							
<b>Wage and salary disbursements</b>							
CBO	48.7	48.8	48.9	48.8	48.7	48.6	48.5
Administration	48.7	48.2	48.1	48.0	47.9	47.8	47.7
<b>Other personal income<sup>e</sup></b>							
CBO	36.0	36.4	36.9	37.2	37.6	38.0	38.4
Administration	36.0	36.4	36.7	37.0	37.4	37.7	38.0
<b>Corporate profits<sup>f</sup></b>							
CBO	7.8	7.5	7.2	7.1	7.0	6.9	6.8
Administration	7.8	7.6	7.6	7.6	7.5	7.5	7.7

a. Based on 1987 dollars.

b. Consumer price index for all urban consumers (CPI-U).

c. The *Blue Chip* projects the secondary market rate for three-month Treasury bills; CBO and the Administration project the auction average rate.

d. The *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year Treasury notes.

e. Personal income less wage and salary disbursements.

f. Corporate profits reported are book, not economic, profits.

an annual rate of 2.3 percent between 1959 and 1969, 1.9 percent between 1969 and 1979, and 1.7 percent between 1979 and 1988. The decline continued in the 1988-1994 period--hours worked rose just 1.1 percent. The slowing of growth since the mid-1970s stems largely from the smaller increase in the size of the working-age population (down from 2.1 percent a year during the 1970s to about 1.0 percent in recent years). Growth in hours worked also eased because of a slowdown in the growth of labor force participation rates (that is, the percentage of the working-age population that is working or seeking work). The causes of that slowdown, particularly in recent years, are not well understood, raising the level of uncertainty about projections of growth in hours worked. Many forecasters anticipate a gentle rebound in participation rates during the last half of the 1990s that will result in a slight increase in the growth of hours worked. CBO's assumption that hours worked will rise to 1.3 percent and the Administration's assumption of 1.4 percent are both close to the consensus opinion.

The growth of labor productivity has also fallen--from 2.4 percent during the 1960s, to 1.3 percent during the 1970s, to 1.0 percent between 1979 and 1987. Growth between 1987 and 1994 is currently reported as 1.2 percent, although recent data on labor productivity are subject to revision. Both the Administration and CBO anticipate a slight pickup in productivity growth, largely because of the high rates of investment in recent years. With the rapid growth in the available stock of equipment and technology, the productivity of labor is likely to accelerate moderately. As with growth in hours worked, projections of increases in productivity are subject to great uncertainty. Given that uncertainty, the differences between CBO's and the Administration's assumptions are not large.

## Inflation

The Administration projects somewhat lower inflation than CBO, as measured by the growth of the consumer price index, although the difference is only 0.2 or 0.3 percentage points. Such a small difference in inflation would not normally create any significant difference in projections of the deficit, since it would

affect items on the revenue and outlay sides of the budget in a roughly offsetting way.

The comparison is clouded, however, because CBO and the Administration differ in their projections of the growth of the CPI, which affects indexed programs and tax brackets, relative to that of the GDP deflator, which affects estimates of taxable income. CBO assumes that the CPI will grow significantly faster than the deflator from 1997 through 2000, whereas the Administration assumes only slightly faster growth. Projections of federal outlays are heavily affected by changes in the CPI because it is the index for programs such as Social Security, Supplemental Security Income, and Military and Civil Service Retirement. Projections of federal revenues, however, are affected by changes in the deflator, since the growth in taxable income overall is closely related to the growth in nominal GDP. The Administration's projections indicate that the CPI will grow only about 0.2 percentage points faster than the deflator, whereas CBO anticipates a difference of 0.6 percentage points.

The historical evidence implies that the difference in the growth rates of the CPI and the GDP deflator will be larger than that projected by the Administration. Between 1987 and 1994, the CPI increased an average of 0.5 percentage points a year faster than the GDP deflator. The two measures of price changes differ over the long run primarily because of the way computer prices affect them. Computers constitute a much bigger share of GDP than of the basket of goods used to calculate the CPI, and the continued decline in their prices will dampen the growth of the GDP measure of price far more than that of the CPI. Furthermore, computer expenditures are projected to grow as a share of GDP. The weight of computers in the GDP deflator increases with their share of GDP, whereas the weight of computers in the CPI will continue to be small.

Although computers are the primary cause of the difference in the growth rates of inflation, the measures differ for other reasons as well. One major offset to the effect of computer prices on the relative growth of the CPI and the deflator is medical care. The price of medical care, which is weighted more heavily in the deflator than in the CPI, has risen

faster than the CPI on average over the past 10 years, a trend that is expected to continue. Other sectors, however, reinforce the effect that computers have on the spread between the growth of the CPI and the deflator. Prices of business equipment excluding computers and residential and business structures, which are not included in the CPI, have been increasing much more slowly than the CPI. On balance, the recent trends in those sectors also indicate that the CPI will grow about 0.6 percentage points faster than the GDP deflator over the next several years.

Several revisions in the CPI that the Bureau of Labor Statistics has recently completed or intends to carry out in the next few years would probably slow the growth of that measure. Most of those revisions, however, would also apply to the GDP deflator and thus would not significantly affect the difference between the indexes. In 1998, the Bureau of Labor Statistics will update the weights in the CPI, and that will probably slow the growth of the CPI relative to that of the GDP deflator. But the slowing is unlikely to be large enough to offset the other factors, such as the decline in computer prices, that drive a wedge between those indexes.

## Interest Rates

The projections of CBO and the Administration differ only a little on interest rates in the short term, but more noticeable differences emerge in later years. After 1996, both short-term and long-term nominal interest rates are higher in the Administration's projections than in CBO's. Judged against the projections of the CPI, the Administration's rates are also significantly higher than CBO's. Using CBO's projections of inflation-adjusted interest rates rather than the Administration's would reduce projected deficits for the 1997-2000 period.

The Administration projects that the inflation-adjusted interest rate on three-month Treasury bills will average about 2.3 percent after 1996, compared with 1.7 percent for CBO. The *Blue Chip's* long-range projection of 2.0 percent lies between those two forecasts. All three sets of projections of real short-term interest rates are substantially higher than

the rates that prevailed during the most recent recession and the early years of the expansion. The projected rates reflect the small amount of capacity currently available for further economic expansion; they fall within the range of the real rates that prevailed in the late 1980s. The Administration's projections of real long-term rates are higher than CBO's by about the same margin as the short-term rates (roughly 0.6 percentage points).

## Share of National Income Subject to Taxation

Estimates of future deficits are affected by the projected distribution of total gross domestic product among various income categories, as well as by the overall size of GDP. Some of those categories--such as corporate profits, wages and salaries, and dividends--are taxable income. A projection that assumes a larger share of GDP for income categories that are taxed at relatively high rates would generate a larger revenue estimate than a projection that assumed a smaller share for such categories. Corporate profits and wages and salaries are taxed at the highest effective marginal rates. (The effective marginal tax rate on a given component of income represents the amount of additional tax collected from each additional dollar of income.) Dividends and interest are taxed at a lower effective rate because they are not subject to payroll taxes and some of them are received by tax-exempt entities. Compliance problems reduce the effective tax rate on the income of proprietors.

The Administration's projections of these various income shares reduces estimates of future deficits in the longer term but result in forecasts of deficits for 1995 and 1996 that are higher than CBO's. The Administration's projection of the wage and salary share of GDP is lower than CBO's throughout the 1995-2000 period and the corporate profits share is higher (see Table 4). The Administration's projections of these income shares, together with its projections of the shares of other categories of taxable income (not shown separately in Table 4), result in lower revenues over the next two years in comparison with CBO's projections but higher revenues thereafter.

The Administration's assumption of the share of total taxable income for 2000 is close to the average of the past 20 years, whereas CBO assumes the taxable share will gradually fall. The decline in the CBO projection stems in part from the assumed increase in the share of labor compensation that is not subject to tax, specifically medical care benefits (the employer's share of medical care insurance premi-

ums is a significant part of the compensation to workers, but it is not taxable income). CBO also assumes that dividend income will account for a smaller share of gross domestic product in 2000 than it has recently. This projection is tied to that of the corporate profit share, which has been abnormally high for over two years and is likely to decline over the projection period.

# The Administration's Spending Proposals

**T**he Congressional Budget Office estimates that total federal spending under the policies proposed in the President's budget would grow from \$1,532 billion in 1995 to \$1,954 billion in 2000 (see Table 5). As a percentage of gross domestic product, total annual spending would hardly change at all. It would hover just under 22 percent of GDP throughout the 1995-2000 period. The President's proposals for discretionary spending are responsible for the restrained growth in total spending. Total nondiscretionary outlays other than net interest would grow from 10.6 percent of GDP in 1995 to 12 percent in 2000, and spending for net interest would increase slightly as a percentage of GDP over that period. Under the President's policies, however, total discretionary spending would increase by only \$11 billion from 1995 to 2000 and shrink from 7.8 percent of GDP in 1995 to 6.2 percent in 2000.

---

## Mandatory Spending

The President's policies would have little effect on the growth of mandatory spending. CBO projects that total nondiscretionary spending (excluding net interest) under current laws and policies will grow at an average annual rate of almost 8 percent over the 1995-2000 period--from \$747 billion in 1995 to \$1,088 billion in 2000. Under the President's policies, the growth would be only slightly slower, and outlays in 2000 would be only about \$7 billion lower than CBO's baseline projections.

CBO estimates that savings from mandatory spending policies proposed by the President that would be recorded on the pay-as-you-go scorecard

under the Balanced Budget Act total \$8 billion in 2000 and almost \$17 billion over the 1996-2000 period (see Table 6). The Administration assumes the savings from those policies would be almost \$3 billion higher over the five years. (Because the pay-as-you-go procedures are scheduled to expire at the end of 1998, only the savings for 1996 through 1998--which total about \$3.5 billion--would actually be recorded on the scorecard under current law.) Savings in the Medicare program account for more than \$6 billion of the savings in 2000 and \$11 billion of the five-year total. Those savings are achieved by extending provisions of law enacted in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) that are scheduled to expire at the end of 1998. Almost \$4 billion of the savings in 2000 comes from extending the requirement that Medicare Part B premiums paid by beneficiaries cover 25 percent of the total costs of Part B.

Extending provisions of OBRA-93 that are scheduled to expire in 1998 also accounts for almost all of the proposed \$2.5 billion reduction in spending for veterans' programs in 1996 through 2000. About half of the \$1 billion in savings in 2000 comes from extending the limit on pensions paid to veterans receiving nursing home care paid for by Medicaid (about half of those savings are offset by higher Medicaid costs). Extending current authority to collect payments from commercial insurers for medical services provided by the Department of Veterans Affairs to privately insured individuals produces an additional quarter of the total reduction in spending in 2000.

Proposed limitations on the earned income tax credit would reduce spending for the refundable por-

**Table 5.**  
**CBO's Estimates of the President's Spending Proposals (By fiscal year)**

	Actual 1994	1995	1996	1997	1998	1999	2000
<b>Outlays in billions of dollars</b>							
Discretionary							
Defense	282	271	264	258	255	260	268
International	21	22	21	21	20	20	19
Domestic	<u>243</u>	<u>257</u>	<u>266</u>	<u>269</u>	<u>272</u>	<u>275</u>	<u>273</u>
Subtotal	546	550	551	548	548	555	561
Mandatory	791	843	897	961	1,025	1,096	1,174
Deposit Insurance	-8	-16	-8	-4	-5	-3	-2
Net Interest	203	235	261	271	281	296	312
Offsetting Receipts	-71	-80	-74	-76	-80	-84	-91
Asset Sales	<u>0</u>	<u>0</u>	<u>-1</u>	<u>-4</u>	<u>-3</u>	<u>0</u>	<u>0</u>
Total	1,461	1,532	1,626	1,696	1,765	1,860	1,954
On-budget	1,182	1,244	1,324	1,383	1,439	1,517	1,598
Off-budget	279	289	303	313	326	342	356
<b>Memorandum:</b>							
Gross Domestic Product	6,632	7,036	7,370	7,747	8,152	8,572	9,013
<b>Outlays as a Percentage of GDP</b>							
Discretionary							
Defense	4.3	3.9	3.6	3.3	3.1	3.0	3.0
International	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Domestic	<u>3.7</u>	<u>3.6</u>	<u>3.6</u>	<u>3.5</u>	<u>3.3</u>	<u>3.2</u>	<u>3.0</u>
Subtotal	8.2	7.8	7.5	7.1	6.7	6.5	6.2
Mandatory	11.9	12.0	12.2	12.4	12.6	12.8	13.0
Deposit Insurance	-0.1	-0.2	-0.1	-0.1	-0.1	a	a
Net Interest	3.1	3.3	3.5	3.5	3.4	3.4	3.5
Offsetting Receipts	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0
Asset Sales	<u>0</u>	<u>0</u>	<u>a</u>	<u>a</u>	<u>a</u>	<u>0</u>	<u>0</u>
Total	22.0	21.8	22.1	21.9	21.7	21.7	21.7
On-budget	17.8	17.7	18.0	17.9	17.6	17.7	17.7
Off-budget	4.2	4.1	4.1	4.0	4.0	4.0	4.0

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent.

tion of the credit (which is counted as outlays) by \$2 billion in 1996 through 2000. (The proposals would also increase revenues by more than \$300 million over that period.) The proposals would deny the credit to families with more than \$2,500 in interest and dividend income during a year and would

tighten compliance procedures to ensure that illegal and nonresident aliens did not receive the credit.

More than \$3 billion in savings in 1996 through 2000 is attributed to the President's proposals to speed up and complete the shift in the student loan

**Table 6.**  
**Estimates of the President's Pay-As-You-Go Spending Proposals (By fiscal year, in billions of dollars)**

	1995	1996	1997	1998	1999	2000
<b>Medicare</b>						
Administration estimate	0	-0.1	-0.5	-0.7	-3.1	-5.4
CBO estimate	<u>0</u>	<u>-0.1</u>	<u>-0.5</u>	<u>-0.7</u>	<u>-3.4</u>	<u>-6.2</u>
CBO minus Administration	0	a	a	-0.1	-0.3	-0.8
<b>Accelerate Shift to Direct Student Loans</b>						
Administration estimate	0	-0.3	-0.7	-1.0	-0.9	-1.1
CBO estimate	<u>0</u>	<u>-0.2</u>	<u>-0.7</u>	<u>-0.9</u>	<u>-0.7</u>	<u>-0.7</u>
CBO minus Administration	0	0.1	a	0.1	0.3	0.4
<b>Earned Income Tax Credit</b>						
Administration estimate	0	a	-0.6	-0.6	-0.6	-0.7
CBO estimate	<u>0</u>	<u>a</u>	<u>-0.5</u>	<u>-0.5</u>	<u>-0.5</u>	<u>-0.5</u>
CBO minus Administration	0	a	0.1	0.1	0.1	0.1
<b>Veterans' Programs</b>						
Administration estimate	0	-0.1	-0.1	-0.2	-1.3	-1.4
CBO estimate	<u>0</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-1.0</u>	<u>-1.1</u>
CBO minus Administration	0	a	a	0.1	0.3	0.3
<b>Other</b>						
Administration estimate	0	0.4	0.2	-0.4	-0.1	-0.1
CBO estimate	<u>0</u>	<u>0.1</u>	<u>0.4</u>	<u>0.4</u>	<u>0.5</u>	<u>0.3</u>
CBO minus Administration	0	-0.3	0.2	0.8	0.6	0.4
<b>Total</b>						
Administration estimate	0	-0.2	-1.7	-2.8	-6.1	-8.7
CBO estimate	<u>0</u>	<u>-0.3</u>	<u>-1.3</u>	<u>-1.8</u>	<u>-5.1</u>	<u>-8.2</u>
CBO minus Administration	0	-0.1	0.4	1.0	1.0	0.5

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: This table includes only those proposals that CBO would count for purposes of the pay-as-you-go procedures of the Balanced Budget and Emergency Deficit Control Act of 1985. The President's budget included proceeds from proposed asset sales in its calculation of pay-as-you-go effects. Under current law, proceeds from asset sales are not counted for purposes of the pay-as-you-go enforcement procedures. The President has proposed that the proceeds from the sales in his budget should be counted for those purposes. The President's budget also assumes that reductions in the statutory limits on discretionary spending can be counted as pay-as-you-go savings. CBO believes that changes in the discretionary limits cannot be counted under current law.

a. Less than \$50 million.

program from the government guaranteeing loans made to students by private lenders to the government making the loans directly to the students. Under current law, direct student loans are required to account for 60 percent of the total loan volume in 1998 and subsequent years. Under the President's proposals, direct loans would fully replace guaranteed loans by 1998. Most of the estimated savings resulting from the shift from guaranteed to direct loans stems from the different treatment of adminis-

trative costs in the projections of the loan subsidy costs of the two programs. Under the Credit Reform Act of 1990, administrative costs that are paid directly by the federal government (as are most of the costs associated with direct loan programs) are not included in the estimated subsidy cost of a loan. However, administrative costs that are paid by another entity (as are most of the costs associated with guaranteed loans) are implicitly included in the calculation of the subsidy costs. Therefore, in any esti

**Table 7.**  
**Estimates of the President's Asset Sale Proposals (By fiscal year, in billions of dollars)**

	1995	1996	1997	1998	1999	2000
Naval Petroleum Reserve Elk Hills Crude Oil						
Administration estimate	0	-0.1	-2.6	0	0	0
CBO estimate	<u>0</u>	<u>-0.1</u>	<u>-1.5</u>	<u>0</u>	<u>0</u>	<u>0</u>
CBO minus Administration	0	0	1.1	0	0	0
Federal Housing Administration Nonperforming Notes						
Administration estimate	0	-0.2	0	0	0	0
CBO estimate	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
CBO minus Administration	0	0.2	0	0	0	0
U.S. Enrichment Corporation						
Administration estimate	0	-0.8	-1.1	0	0	0
CBO estimate	<u>0</u>	<u>-0.5</u>	<u>-1.1</u>	<u>0</u>	<u>0</u>	<u>0</u>
CBO minus Administration	0	0.3	0	0	0	0
Power Marketing Administrations						
Administration estimate	0	-0.1	-0.9	-3.5	0	0
CBO estimate	<u>0</u>	<u>-0.1</u>	<u>-0.9</u>	<u>-3.5</u>	<u>0</u>	<u>0</u>
CBO minus Administration	0	0	0	0	0	0
Total						
Administration estimate	0	-1.2	-4.6	-3.5	0	0
CBO estimate	<u>0</u>	<u>-0.7</u>	<u>-3.5</u>	<u>-3.5</u>	<u>0</u>	<u>0</u>
CBO minus Administration	0	0.5	1.1	0	0	0

SOURCE: Congressional Budget Office.

NOTE: The President's budget included proceeds from proposed asset sales in its calculation of pay-as-you-go effects. Under current law, proceeds from asset sales are not counted for purposes of the pay-as-you-go enforcement procedures. The President has proposed that the proceeds from the sales in his budget should be counted for those purposes.



mate of savings from shifting from guaranteed loans to direct loans, at least some administrative costs will drop out of the calculation of the subsidies.

The President's proposals also include some changes in mandatory spending that would not appear on the pay-as-you-go scorecard. For instance, the President has proposed selling naval petroleum reserves, three power marketing administrations, and the United States Enrichment Corporation (along with the highly enriched uranium owned by the corporation). CBO estimates that proceeds from those proposed sales would total almost \$8 billion in 1996 through 1998 (see Table 7). However, under current law, those proceeds are not counted as deficit reduction for purposes of the pay-as-you-go procedures. The President has proposed changing the law to allow those proceeds to be counted for those purposes.

In addition, some changes in mandatory spending are not included on the pay-as-you-go scorecard because they do not directly result from a change in laws governing mandatory programs. Virtually all of the increase in spending in that category--nearly \$4 billion over the 1995-2000 period--is the result of the President's proposed pay raises for federal civilian employees and military personnel, which are lower than those provided in current law (see Table 8). Because almost all expenditures for pay are categorized as discretionary, little of the direct effects of the lower pay shows up in mandatory programs. However, the budget category of offsetting receipts--which is considered mandatory--is affected. Federal agencies and the armed services are required to make payments, which are equal to a specified percentage of pay, to the civil service and military retirement trust funds on behalf of civilian employees and

**Table 8.**  
**Pay Raises Under CBO's Current-Law Assumptions and the President's Budget (By fiscal year, in percent)**

	1996	1997	1998	1999	2000
<b>CBO's Estimate Under Current Law</b>					
Civilian Raises <sup>a</sup>					
Across-the-board raises	2.4	3.2	3.1	3.0	3.0
Locality raises <sup>b</sup>	<u>3.1</u>	<u>2.4</u>	<u>2.3</u>	<u>2.4</u>	<u>2.4</u>
Total	5.6	5.7	5.5	5.4	5.5
Military Raises	2.4	3.2	3.1	3.0	3.0
<b>President's Budget Proposal</b>					
Civilian Raises <sup>c</sup>	2.4	3.1	2.1	2.1	2.1
Military Raises	2.4	3.1	3.1	3.1	2.1

SOURCE: Congressional Budget Office.

- Civilian raises shown apply to General Schedule employees. That group makes up the largest portion of the federal civilian workforce.
- CBO adjusts locality raises to account for employees who do not receive the full amount of those raises because they are already receiving supplements to their pay.
- The President's budget does not make any assumptions about how the total annual pay increases it proposes should be distributed between across-the-board raises and locality raises.

military personnel. The payments received by the trust funds are recorded as offsetting receipts, or negative outlays. The President's proposal to reduce future pay increases compared with the raises that would occur under current law would also reduce the amounts received by the retirement trust funds on behalf of the employees--lowering offsetting receipts and increasing net outlays.

---

## Discretionary Spending

CBO has estimated that the total discretionary appropriations proposed by the President would result in outlays that increase by only \$11 billion over the next five years--from \$550 billion in 1995 to \$561 billion in 2000. That total includes both proposed anticrime spending from the Violent Crime Reduction Trust Fund (VCRTF) and all other, or general purpose, appropriations. Total discretionary appropriations in 2000 under the President's proposals are almost 16 percent (about \$100 billion) below the level that would be needed to keep pace with inflation, assuming enacted funding for 1995 as the starting point.

CBO estimates that the general purpose discretionary spending proposed by the President is less than the statutory limits in 1996 through 1998 (the limits are scheduled to expire after 1998). If one excludes spending resulting from emergency appropriations proposed in the President's budget (which would result in an adjustment to the limits if enacted), discretionary outlays would be about \$2 billion below the limit in 1996, \$7 billion below the limit in 1997, and \$11 billion below the limit in 1998. The President has proposed reducing the discretionary limits for those years to the levels of discretionary spending in the budget as estimated by the Administration. The budget also recommends extending the limits through 2000 at the levels of spending proposed for those years.

The President's budget proposes specific appropriations from the VCRTF for 1996. The budget authority requested is only \$15 million below the \$4,287 million available for appropriation from the fund. CBO estimates that outlays will be \$204 million below the \$2,334 million limit on VCRTF out-

lays established in the Violent Crime Control and Law Enforcement Act of 1994. The budget does not identify specific VCRTF appropriations for 1997 and later years but instead simply assumes that budget authority and outlays will equal the full amount identified in the crime bill (the budget authority increases to \$6,500 million in 2000, and outlays grow to \$6,225 million).

The President has also proposed almost \$11 billion in 1995 appropriations for emergency purposes. CBO estimates that outlays from those appropriations would equal nearly \$2 billion in 1995, more than \$1 billion in 1996, and \$2 billion a year in 1997 through 1999. Nearly \$3 billion of the requested funding would go to the Department of Defense to offset the costs of peacekeeping and humanitarian assistance operations in and around Iraq, Bosnia, Haiti, Cuba, and Korea. Somewhat less than \$1 billion would be appropriated for the U.S. share of additional costs of United Nations peacekeeping operations. Almost all of the remaining \$7 billion of the requested emergency appropriations would go to the Federal Emergency Management Agency to meet additional costs of the 1994 Northridge earthquake in Southern California and various other disasters in over 40 states.

The President has requested total discretionary budget authority of \$538.3 billion for 1996. Excluding the outlay effect of proposed 1995 supplemental appropriations and rescissions (including proposed emergency appropriations), CBO estimates that 1996 outlays resulting from the President's proposals would total \$549.4 billion. The President's proposals do not represent a dramatic shift in priorities, but certain areas of the budget fare better than others. The winners and losers can be determined by comparing CBO's estimate of the discretionary appropriations requested by the President for 1996 with its estimate of the level of spending if 1996 appropriations for each account were frozen (with some minor technical adjustments in a few accounts) at the amount appropriated in 1995 (see Table 9).

In order to facilitate the comparison, CBO's freeze has been adjusted to account for a proposed change in the way budget authority is provided for some transportation trust fund programs dealing with highway, mass transit, and air transportation. Under

the current system, the budget authority for those programs is provided in authorizing legislation and is considered mandatory spending. When appropriation bills subsequently impose obligation limits that restrict the use of that budget authority, the outlays for the programs are charged to those bills as discretion-

ary spending. Under the President's proposals, the budget authority would be provided in appropriation bills instead of in the authorizing legislation. To compare its freeze estimate accurately with the President's request for transportation appropriations, which includes budget authority for those programs,

**Table 9.**  
**The Administration's Proposals for Discretionary Spending in Fiscal Year 1996 (In billions of dollars)**

	Funding at the 1995 Enacted Level as Estimated by CBO		President's Budget as Estimated by CBO <sup>a</sup>		President's Budget Minus 1995 Enacted Level	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Defense	262.9	263.6	258.3	262.0	-4.6	-1.7
International	20.4	21.1	21.3	21.2	0.9	b
Domestic						
General science, space, and technology	17.1	16.9	17.2	17.0	0.1	0.2
Energy	6.6	6.7	5.9	6.4	-0.6	-0.3
Natural resources and environment	21.6	21.3	22.4	21.7	0.8	0.5
Agriculture	4.0	4.0	4.0	4.1	b	b
Commerce and housing credit	3.4	3.2	3.5	3.2	0.2	b
Transportation <sup>c</sup>	38.4	39.1	36.5	39.0	-1.9	-0.1
Community and regional development	8.8	10.4	9.7	10.9	0.9	0.5
Education, training, employment, and social services	42.0	41.2	44.5	42.6	2.5	1.4
Health	22.8	22.3	23.7	22.6	0.9	0.3
Medicare	3.0	3.0	3.2	3.2	0.2	0.2
Income security	33.6	39.2	33.6	40.4	-0.1	1.2
Social Security	0	2.6	0	3.2	0	0.6
Veterans' benefits	18.3	19.0	19.3	19.1	1.0	0.2
Administration of justice	18.1	17.9	21.5	19.7	3.4	1.8
General government	12.3	12.5	13.7	13.2	1.4	0.7
Subtotal, domestic <sup>c</sup>	250.1	259.3	258.7	266.3	8.6	7.0
Total, discretionary spending <sup>c</sup>	533.4	544.0	538.3	549.4	4.9	5.4

SOURCE: Congressional Budget Office.

a. These figures exclude the effects of proposed 1995 rescissions or supplemental appropriations.

b. Less than \$50 million.

c. CBO's projection of budget authority for transportation has been adjusted to reflect a proposed change in the method of providing budget authority from the transportation trust funds for a number of programs.

CBO has increased the freeze estimate by an amount of budget authority equivalent to the 1995 obligational authority for those transportation programs.

In total, the discretionary budget authority requested by the President for 1996 is about \$5 billion, or 1 percent, above the level of appropriations enacted for 1995. Proposed defense appropriations, however, are nearly \$5 billion (2 percent) below the 1995 level, whereas nondefense appropriations are more than \$9 billion (3 percent) higher than in 1995.

### Nondefense Discretionary

The largest increase in percentage terms is in the area of administration of justice. Under the terms of the Violent Crime Control Act, nearly \$2 billion more can be appropriated from the Violent Crime Reduction Trust Fund for 1996 than is available in 1995. The President's budget proposes using virtually all of the funds available, significantly increasing spending in the administration of justice category. Other categories with relatively large proposed increases over 1995 funding levels include general government and community and regional development. About half of the proposed \$1.4 billion increase for general government activities is for the Internal Revenue Service. The growth in community and regional development funding primarily reflects a proposed increase in appropriations for rural development programs.

The largest reduction below the 1995 appropriated level in percentage terms is in the energy area. However, more than half of the proposed \$600 million cut comes from eliminating discretionary appropriations from the Nuclear Waste Fund, which is part of the Administration's proposal to begin funding nuclear waste activities through a mandatory account. The next largest reduction is in the funding requested for transportation programs. As noted above, the President has proposed a significant change in the way funds from the transportation trust funds are made available. In addition to having the spending authority provided directly in appropriation bills, the President has proposed a restructuring of the accounts through which the funds flow. When that re-

structuring is taken into account, and the 1995 appropriations are adjusted to conform to the approach of the 1996 proposal, the President's proposal for 1996 transportation funding is \$2 billion below the funding provided in 1995.

### Defense Discretionary

The President has requested \$258 billion in funding for defense programs in 1996 and about \$1.3 trillion over the 1996-2000 period. Defense appropriations would continue to fall through 1997; the proposed increases after that would about keep pace with inflation. The proposed defense budget would support a force of about 1.4 million people in uniform on a full-time basis and an additional 0.9 million part-time or reserve personnel. Those forces would serve in 13 active Army and Marine Corps divisions, 42 reserve brigades, 358 Navy ships (including 12 aircraft carriers), and 13 active and 7 reserve Air Force air wings. The budget provides sufficient funding to maintain training rates and keep equipment in good repair--both of which are necessary to ensure that the forces are ready to fight on short notice. In order to modernize weaponry, the budget would boost procurement funding beginning in 1997, with an especially large increase in 1998.

Last year there was concern that the President's fiscal year 1995 budget request for defense spending in 1996 through 1999 was not sufficient to fund the plan put forward by the Department of Defense. CBO attributed that potential underfunding to the failure of the budget request to provide fully for the general inflation assumed by the Administration, pay raises for military and civilian personnel, growth in the cost of weapons, base closing costs, quality-of-life improvements, and contingency operations.

The President's 1996 budget has substantially reduced the potential funding gap. The Administration has lowered its forecast of inflation since last year--reducing the difference between the assumptions supporting the budget and those used in preparing the Department of Defense plan. In addition, the new budget added \$10 billion in 1996-1999 funding (\$25 billion through 2002) for the out-year costs of 1995

pay raises and for other expenses such as child care, maintenance of facilities, and purchases of munitions.

In total, however, the request for defense funding for the 1996-1999 period is only \$7 billion higher than it was a year ago. Therefore, the reduction in the potential underfunding has been achieved primarily by assuming lower spending in other areas of the defense budget. For instance, plans for closing bases have been scaled back, reducing the one-time costs associated with those closings. More important, the fiscal year 1996 budget includes about \$28 billion less for procurement than was requested last year. Proposed funding for procurement in 1996 alone is \$9 billion lower than previously planned: Navy funding for weapons has plunged by nearly \$5 billion (25 percent), Air Force funding is down by \$4 billion (18 percent), and Army funding has fallen by \$1 billion (10 percent).

The Department of Defense would save about \$6 billion in 1996 through 1999 by cancellations or delays in several major programs:

- o The Tri-Service Standoff Attack Missile was cancelled.
- o No Comanche helicopters will be bought after two prototypes are produced.
- o Purchases of a new attack submarine, new destroyers (DDG-51s), the V-22 Osprey aircraft, an advanced amphibious assault vehicle, and the F-22 fighter aircraft will be stretched out over a longer period of time than planned earlier.

Some of those changes are the result of problems with the weapons (for instance, the failure of the Tri-Service Standoff Attack Missile to meet specifications and stay within planned costs) or revised estimates of needs. Other changes, however, are clearly the result of attempts to make defense plans conform to budgetary constraints.



# The Administration's Revenue Proposals

**T**he Congressional Budget Office estimates that revenue would grow from \$1.355 trillion this year to \$1.678 trillion in 2000 under the policies included in the President's budget (see Table 10). As a percentage of gross domestic product, revenue is projected to fall from 19.3 percent this year to 18.6 percent in 2000. Enacting the President's proposals would reduce revenues by \$2 billion in 1996 and by \$20 billion, or 0.2 percent of GDP, in 2000, but would add \$0.1 billion to revenues in 1995 (see Table 11).

The two largest proposed tax cuts--a tax credit for dependent children and a new deduction for education and training expenses--would not be fully effective until tax returns are filed in 2000. Revenue losses would also be limited in the early years because the proposal to expand individual retirement accounts (IRAs) would bring in revenues if, as expected, taxpayers transfer their existing IRA funds to the new IRAs proposed by the Administration. After 2000, revenue losses would no longer increase faster than incomes, except for losses from the proposed IRA, which can be expected to accelerate over time.

Under the current pay-as-you-go limits, the \$60 billion of net tax reduction proposed by the Administration would have to be offset by cuts in mandatory spending or increases in other taxes. If the Administration's revenue proposals became law without legislation offsetting the tax reduction or modifying the pay-as-you-go rules, automatic cuts in mandatory spending would be triggered.

The Joint Committee on Taxation (JCT) prepared the estimates for the Administration's revenue pro-

posals, except for those involving fees. CBO provided the estimates for fees. As a whole, the JCT and CBO estimates are similar to the Administration's.

---

## Tax Relief for Middle-Income Families

The major tax initiative in the President's budget aims to reduce taxes for middle-income families. The Administration proposes to provide tax relief for middle-income families through a nonrefundable tax credit for families with young children, a deduction for postsecondary education and training expenses, and expanded benefits for saving through IRAs. The JCT estimates that the three proposals together would cost \$66 billion over the next five years.

### Tax Credit for Families with Young Children

The Administration proposes a nonrefundable tax credit for each dependent child under the age of 13. The credit would be phased in at \$300 per child for 1996, 1997, and 1998, and \$500 per child in 1999 and thereafter. The credit would be applied to any remaining tax liability after the earned income tax credit and would be reduced for families with adjusted gross income (AGI) between \$60,000 and \$75,000. Families with AGI of \$75,000 or more would not be eligible for the credit. The amount of the credit and the phaseout range would be indexed for inflation beginning in 2000.

Few families with adjusted gross income below \$20,000 would receive the credit. Because it is non-refundable, the credit would not be available to families that owe no federal income taxes. Few families with income below \$20,000 owe income tax once the earned income tax credit is applied.

The JCT estimates that the Administration's proposed credit would cost \$1.4 billion in 1996 and \$33.4 billion over five years (see Table 12). The annual cost of the credit would rise to \$10.6 billion in

2000, by which time the full \$500 credit would apply. The JCT assumes that fewer families would take immediate advantage of the credit by adjusting their withholding rather than realizing the benefits when their taxes come due in the following year. That factor reduces the cost of the credit initially and when the credit amount increases from \$300 to \$500 but has little impact in later years.

Title VI of the Tax Fairness and Deficit Reduction Act of 1995 (H.R. 1215) also proposes a family

**Table 10.**  
**CBO's Estimates of Revenues Under the President's Proposals (By fiscal year)**

Source	1995	1996	1997	1998	1999	2000
<b>In Billions of Dollars</b>						
Individual Income	594	625	644	679	715	752
Corporate Income	149	151	156	162	168	173
Social Insurance	494	517	539	565	590	618
Excise	56	56	57	58	59	59
Other	<u>63</u>	<u>67</u>	<u>68</u>	<u>70</u>	<u>72</u>	<u>75</u>
Total	1,355	1,416	1,464	1,534	1,604	1,678
On-budget	998	1,041	1,072	1,122	1,173	1,226
Off-budget	357	375	392	411	431	452
<b>Memorandum:</b>						
Gross Domestic Product	7,036	7,370	7,747	8,152	8,572	9,013
<b>As a Percentage of GDP</b>						
Individual Income	8.4	8.5	8.3	8.3	8.3	8.3
Corporate Income	2.1	2.1	2.0	2.0	2.0	1.9
Social Insurance	7.0	7.0	7.0	6.9	6.9	6.9
Excise	0.8	0.8	0.7	0.7	0.7	0.7
Other	<u>0.9</u>	<u>0.9</u>	<u>0.9</u>	<u>0.9</u>	<u>0.8</u>	<u>0.8</u>
Total	19.3	19.2	18.9	18.8	18.7	18.6
On-budget	14.2	14.1	13.8	13.8	13.7	13.6
Off-budget	5.1	5.1	5.1	5.0	5.0	5.0

SOURCE: Congressional Budget Office.



tax credit. Although the Administration's proposal and H.R. 1215 would both provide a \$500 credit for each dependent, the two specify eligibility for the credit in significantly different ways. The Administration's proposal would limit eligibility for the full credit to families with AGI under \$60,000; H.R. 1215 would limit it to families with AGI under \$200,000 (the tax credit would phase out over a \$50,000 income range for families with AGI in excess of \$200,000). The Administration's proposal would allow a credit for each dependent child under the age of 13; H.R. 1215 would allow a credit for each dependent child under age 18. The Administration's proposal would not allow families to receive the credit if the earned income tax credit (EITC) eliminated their tax liability; H.R. 1215 would allow families to claim the credit if tax liability was positive before applying the EITC.

The family tax credit in H.R. 1215 would cost more than the Administration's proposal (about two and one-half times as much on an annual basis by 2000) because more families would be eligible and the average amount received per family would be higher. Those differences would occur because of the higher income limit, because families with children 13 to 17 years old would qualify, and because

the credit would apply to tax liability before the EITC.

The Administration's proposal would raise the after-tax income of families with children by a small amount--an average of between 1 percent and 2 percent for eligible families with income between \$20,000 and \$75,000. Although additional after-tax income could cause some parents to reduce the number of hours they worked, such small changes in after-tax income would not lead to a significant labor market response. Phasing out the credit for higher-income families would raise their marginal tax rates. The approximately 3 million families who have income between \$60,000 and \$75,000 and who are eligible for the credit would see an increase in their marginal tax rate of about 3 percentage points for each eligible child once the \$500 per child credit was payable. Higher marginal tax rates are a consequence of any phaseout of benefits that is conditional on income.

### Tax Deduction for Education and Job Training

The Administration proposes a deduction for qualified expenses for postsecondary education. Taxpay-

**Table 11.**  
**Comparison of Revenue Estimates of the President's 1996 Budgetary Proposals**  
(By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	1995- 2000
CBO/JCT	0.1	-2.1	-11.3	-12.6	-14.5	-19.5	-59.9
Administration	<u>a</u>	<u>-3.0</u>	<u>-10.4</u>	<u>-10.9</u>	<u>-13.6</u>	<u>-18.1</u>	<u>-56.0</u>
Difference	0.1	0.9	-0.9	-1.6	-0.9	-1.4	-3.9

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

NOTE: JCT = Joint Committee on Taxation.

a. Less than \$50 million.

ers would be allowed to deduct the expenses of education and training for themselves, their spouses, or their dependents. The maximum deduction would be \$5,000 in 1996, 1997, and 1998, and \$10,000 in 1999 and thereafter. The deduction would be phased out for couples with income between \$100,000 and \$120,000 and for single taxpayers with income between \$70,000 and \$90,000. The income phaseout range would be indexed for inflation beginning in 2000.

The deduction would apply to adjusted gross income. Thus, in order to qualify for the new deduction, taxpayers would not need to itemize deductions or meet the current floor of 2 percent of AGI that applies to certain deductible education and other business-related expenses under current law.

The deduction would apply to qualified education expenses, defined as tuition and fees directly related to a course of studies for which an eligible student is

**Table 12.**  
**Comparison of Revenue Estimates of the President's 1996 Budgetary Proposals to Provide Tax Relief to Middle-Income Families (By fiscal year, in billions of dollars)**

	1995	1996	1997	1998	1999	2000	1995- 2000
<b>Tax Credit for Families with Young Children</b>							
CBO/JCT	0	-1.4	-7.0	-6.9	-7.5	-10.6	-33.4
Administration	0	-3.5	-6.8	-6.6	-8.3	-10.1	-35.4
<b>Education and Training Tax Deduction</b>							
CBO/JCT	0	-1.7	-5.0	-6.0	-6.7	-7.0	-26.4
Administration <sup>a</sup>	0	-0.7	-4.7	-4.9	-5.7	-7.5	-23.5
<b>Expanded Individual Retirement Accounts</b>							
CBO/JCT	0	0.2	-0.4	-1.0	-1.7	-3.4	-6.3
Administration	0	0.4	-0.3	-0.8	-1.0	-2.0	-3.8
<b>Total Tax Relief for Middle-Income Families</b>							
CBO/JCT	0	-2.9	-12.5	-13.8	-15.9	-21.0	-66.1
Administration	0	-3.8	-11.8	-12.4	-15.1	-19.6	-62.7

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

NOTE: JCT = Joint Committee on Taxation.

a. After the budget was published, the Treasury Department issued slightly revised estimates of this provision. The revised estimates are -\$5.0 billion in 1998, -\$5.8 billion in 1999, and -\$7.6 billion in 2000.